A CASE STUDY ON MUNICIPAL DEVELOPMENT FUND IN NEPAL

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A. INTRODUCTION:

- 1. Nepal, a landlocked country bordering Tibet, an autonomous region of the Peoples Republic of China on the North and India on the East, West and South, has an area of 147,181 square kilometer. Administratively, the country is divided into five development regions and 75 districts which are further divided into 3,995 village development committees and 36 municipalities.
- 2. The present population of Nepal has been estimated at about 21 million, out of which about 2.3 million people live in Urban areas. In 1971 about 4% of the population lived in urban centre whereas the corresponding figure for 1996 is estimated at 11% which clearly indicates increased urbanization trend during the period. The Kathmandu Valley maintains the highest urban concentration in the country.
- 3. His Majesty's Government of Nepal (HMGN) has adopted the decentralization policy which aims at transferring more and more authority and responsibility to the local governments and recognizes that it is only possible to attain accelerated development through the utilization of local initiatives, resources and skills. One of the basic objectives of HMGN as quoted in the Eighth Development Plan (1992-1997) includes promotion of planned urban development and management of urban area by making the process of urbanization complementary to the growth of the local economy.
- 4. The increased urbanization process has brought in several problems such as overcrowding, sprawl of squatter settlements, uncontrolled establishment of environmentally unfavorable industries, condition of inadequate infrastructural services and facilities and general environmental degradation.
- 5. The financial conditions of municipalities is generally poor. Their main sources of income includes trade tax and octroi which do not allow them to venture into expensive projects unless they are supported by HMGN or any other agency like the Town Development Fund Board in terms of loan or grant. However, HMGN is seriously thinking that municipality should change its finance system from indirect tax like octroi to direct taxes such as property based taxes, the business tax and the vehicle tax etc.

6. The urban planning and development sector involves a number of government agencies. The Ministry of Housing and Physical Planning (MHPP) is responsible for overall formulation of policy and strategies for the sector. Department of Housing and Urban Development has the responsibility to implement programmes of urban development within policies and strategies developed by MHPP. Town Development Committee is an autonomous corporate body whose responsibility includes undertaking land development programmes and control of actions contrary to the healthy development of areas within their jurisdiction. Nepal Housing Finance Development Company is a semi-private company which is extending housing loans to a limited extent. Town Development Fund board (TDFB) was established in 1989 with two main functions i.e to provide financial resources to municipalities and to strengthen their managerial capabilities.

B. ESTABLISHMENT OF TDFB AND ITS FINANCIAL SOURCES:

- 7. In Nepal financial and commercial banking institutions are not geared to provide loans, particularly for social infrastructure projects. They are difficult to be handled because of several factors like lengthy procedure of loan sanctioning, high collateral against the loan, inefficiency and absence of investment policy in urban development in general. On the other hand, the municipalities are very reluctant to take loan from banks as the interest rate is very high (16% to 22%). At the same time, the banking institution, too, do not seem to be willing to extend loans to the municipalities whose board is composed of various political party members and they doubt whether municipalities would pay back their principal and interest in time.
- 8. The TDFB has, thus, been established to finance the municipalities for their social infrastructure and revenue generating projects as there was no such institution as mentioned above. Even today, the TDFB is the only institution which provides finance to the municipalities in Nepal. The main objectives of the TDFB are:
 - to provide financial support to municipalities for the implementation of social infrastructure and revenue generating projects, and
 - to strengthen the technical and managerial capability of municipalities to implement the projects.
- 9. From its beginning until July 1996, the TDFB was financed by loans from the World Bank and by grants from GTZ and 273 grant and 41 loan projects were completed at a cost of approximately US \$ 4.7 million. Although the type of projects differed according to the priorities and needs of the municipalities; the most popular ones included sanitation, environmental improvement and revenue generating projects.

10. A new financing agreement was concluded in December 1995 between the Federal Republic of Germany and His majesty's Government of Nepal to enable the TDFB to continue its support to municipalities. Under this agreement, the Federal Republic of Germany through "Kreditanstalt für Wiederaufbau" (KfW) has provided grant fund of DM 10 million to the TDFB for continuing its activities until December 2000. The fund will be used for grants and loans to municipalities, as well as local consultancy services for project studies and construction supervision. Interest and loan repayment from the municipalities will be turned into a revolving fund by the TDFB to finance further projects.

C. PRESENT CASE STUDY:

11. General:

The present case study elaborated in the following lines deals with the loan projects funded by "International Development Association" (IDA) and grant projects funded by "Deutsche Gesellschaft Für Technische Zusammenarbeit" (GTZ). The project funded by IDA was closed on June 30, 1996 and that by GTZ on July 31, 1996. This case study, involving complete project cycle, has been picked up because of the fact that they provide a lot of insight for our future loan and grant programmes. These facts were also discussed with World Bank mission which visited Kathmandu recently and Urban Development through Local Efforts (udle/GTZ) for their respective projects.

12. Loan and Grant Policy and procedure:

In short, loan and grant policy and procedure of the TDFB were as follows:

13. Loan policy:

On the basis of feasibility study report and Technical documents prepared by municipality, the TDFB provided loans to the different components of social infrastructure and revenue generating project (See Annex-1)

(a) Terms and condition

Type of Project	Interest Rate	Maturity Including Grace Period	Maximum Grace Periods
Social Infrastructure	8%	18 yrs.	3 yrs.
Revenue Generating	12%	12 yrs.	2 yrs.

The grace period was counted from the date of signing the loan agreement to the date when the first payment of principle and interest was due. Interest was to be paid at the end of each semester (mid January and July).

(b) Eligibility of Municipalities for loans

Those municipalities which had demonstrated a capacity to manage their investments and generate sufficient net income to service debt, as indicated below, were eligible for loans from the TDFB.

- Having a positive "CURRENT ACCOUNT SURPLUS" in the most recent two fiscal years, i.e locally collected revenues minus current operating expenditures minus committed capital investment and debt services, and
- Having a projected current account surplus based on past three years trend to service the minimum size project loan.

(c) Loan application procedure

Municipality was supposed to submit the following documents along with the loan application

- Attested copy of approval of municipal board for loan application.
- Detailed particulars of project and feasibility study with master plan, detailed drawing, design and cost estimate of the project.
- Economic justification of project if requested loan amount is more that US \$ 0.14 million. (Additional particulars may also be necessary in addition to the above depending on the type of project).

(d) Limits on Loan Amounts

- (i) Minimum loan amount for each project was US \$ 5000.00 and the maximum was US \$ 0.4 million.
- (ii) The TDFB provided loans upto 90% of the estimated project cost excluding the cost of the land and the municipality furnished the remaining 10% as the matching fund from its own source.

TDFB did not provide loan for land purchase and acquisition.

(e) Loan Disbursement Procedure

The municipality opened a separate bank account and deposited the matching fund for the project prior to its commencement. The municipality forwarded the checked bill of the work submitted by the contractor to the TDFB. The TDFB disbursed the loan amount against each running bill out of the proceeds of the loan in the proportion agreed on the loan agreement. Separate bank account was to be maintained for each project.

(f) Monitoring of the Project

The TDFB monitored the projects during its implementation to ensure that the loan was being used in accordance to the agreement. Upon completion of the project, the municipality prepared a project completion report which included a summary of all project expenditures and certification of compliance with the loan Agreement.

14. **Grant Policy:**

(a) Types of Projects:

Grants were made available to the municipalities on a matching fund basis. The municipalities were divided into three categories "High", "Medium" and "Low" on the basis of their annual revenue and per capita income of the people. The types of grant projects for which High, Medium and Low income municipalities could apply for are listed in the Annex -2. The percentage of grant contribution from the TDFB and the maximum grant amount that could be made available to the municipalities per project are also given in this Annex.

The matching fund could be either cash or material or labour but did not include the cost of land acquisition.

(b) Appraisal criteria:

The following criteria were applied for the appraisal:

- technical, financial and environmental feasibility;
- consistency with overall local development aims;
- contribution to the town's revenue base;
- availability of matching funds from the municipalities.

(c) Disbursement of Grant:

Grant amounts were disbursed in accordance with the progress of work. One third (1/3) of the grant after the start of the project, another one third (1/3) of the grant on the basis of work progress. And the balance amount after completion of the work. For small grant up to US \$ 900, the disbursement can be made in one instalment.

(d) Reporting Requirements for Grant Assistance:

For each project approved, progress reports indicating physical implementation and utilization of funds would be prepared by municipalities and submitted to the TDFB every four months.

A project completion report together with a final financial statement of the cost of the project should be submitted to the TDFB by the municipalities not later than forty-five (45) days after completion of the work.

(e) Monitoring:

The TDFB monitored the execution of the project as well as the operation and maintenance after completion either on its own or in cooperation with the local consultant.

D. PRINCIPAL CONSTRAINTS OR DIFFICULTIES IN IMPLEMEN-TATION PROCESS:

15. Difficulties Faced in Loan Project:

The various difficulties faced during implementation of the loan projects funded by IDA were as follows:

- (a) In order to apply for the loan the municipalities were supposed to present the feasibility studies and detail design of the project invariably. But the municipalities were not ready to use loan amount for conducting feasibility studies and detailed design of the project.
- (b) Municipalities lacked the technical expertise to initiate projects and prepare loan application documentations.
- (c) For a large project like the construction of stormwater drainage and bus park, the implementation process got delayed or the work remained incomplete due to court cases involving dispute with the people and change of alignment and technical design.
- (d) According to the prevailing financial regulation in Nepal, the lowest bidder would be awarded the contract unless and until there were sufficient reasons for awarding the contract to the second or the third lowest. However, the municipalities board did not like to take this risk and wanted to complete the project in less cost so that the loan amount of the municipality would come down.

The cartel of the contractors at the time of bidding also created problems for selecting a good contractor.

- (e) Long bureaucratic procedure of the government organizations and the municipalities for making decision in time also is one of the constraints at the implementation stage. Usually approval of the tender by the municipal board takes a long time and change of alignment or technical design of work if required to be changed takes further unnecessary long-time due to various political, administrative and technical reasons.
- (f) As any change in the technical design or any kind of other changes leading to the escalation of cost needed to be submitted to the donor agency for approval. This process, sometimes took a long time.
- (g) As the TDFB was not fully autonomous, it had to take approval of the government ministry for several important issues. This was also a constraint leading to delayed implementation process.
- (h) Often the members with different political party affitiation in a municipal board some time could not agree to the priority implementation area of social infrastructure projects. Each politician considered his area as priority.

(i) Ceiling of US \$ 0.4 million loan to any one municipality had proved inadequate for the development requirements of the municipality's infrastructure services.

16. Difficulties Faced in Grant Projects:

As compared to the loan projects, grant projects did not experience much difficulty at the time of implementation. However, the constraints related to the municipalities, contractors and organization as said above persisted. The TDFB was fully authorized to approve the changes in the technical design and increase in the project cost estimate.

E. LESSONS LEARNED FOR FUTURE OPERATION:

- 17. With the experience of eight years, the TDFB has learned many lessons for future operations which are as follows:
- (a) Adequate analysis and studies of requirements and attitudes of the municipalities need to be carried out.
- (b) Rescheduling of the investment programmes and difficulties faced during the implementation stage of the projects should be discussed at the time of the mission visit. The mission also should try to find out the difficulties experienced by the organization and solve them.
- (c) Establishment of an autonomous organization with a concept of Urban Development Bank should be given serious consideration.
- (d) The technical capabilities of the prospective contractors should be well evaluated and they need to be properly oriented to the requirement of the organization and municipalities by holding pre-bid meeting in order to avoid problems at a later stage.
- (e) The financial, managerial and technical capabilities of the municipalities with regard to preparation, implementation, supervision and the management of the projects should be developed through training, seminar, workshop, tour visit etc.
- (f) The donor should also realize the economic, social, technical, educational and political situation of the country for which their fund is being invested and formulate appropriate rules and regulation for the receipient

community, i.e municipalities in the present case.

F. CURRENT SITUATION OF TDFB:

- 18. In view of the problems faced in the past a separate Act "Town Development Act, 1996" has been recently approved by both the houses of the parliament and is awaiting for the Royal Assent. The Act has provided sufficient administrative and financial autonomy to the board to operate independently and efficiently in future. The salient features of the Act are as follows:
- a. It is established to provide essential financial, technical and institutional support to the institutions relating to the town development for the construction, development and expansion of Town.
- b. The Fund shall be an autonomous and corporate body having perpetual succession.
- c. It can approve the organizational structure of the Fund and to create necessary posts accordingly.
- d. The Fund may issue and purchase debenture and other types of Bond after fulfilling the process provided by the prevailing laws.
- e. The accounts of the Fund shall be audited by the auditor appointed by the Board from among the auditors registered in the office of the Auditor General in consultation with the Auditor General's Office.

G. NEXT STEPS OF TDFB:

- 19. (a) The TDFB, being established as fully autonomous body under its own enabling Act, would now proceed to be converted into an Urban Development Bank under the present "Development Bank Act". The TDFB is now authorized to contract external donor agencies as well as HMGN, national banking institutions and individuals for necessary actions.
 - (b) The TDFB, would like to extend its activities in larger village development committees which are likely to be converted into municipalities in near future. The TDFB would contact additional national and International donors to provide financial assistance for this purpose.
 - (c) The TDFB would take necessary steps to enhance the technical and managerial capability of municipalities through various activities.

Annex - 1

TYPES OF LOAN PROJECTS AND PORPORTIONS OF FINANCIAL CONTRIBUTIONS

Project Types IDA Loan HMG Equity Municipal Matching Fund A. SOCIAL INFRASTRUCTURE PROJECTS 80% 10% 10%

- Roods and Bridges
- Drainage Systems
- Footpaths and Side Walks
- Publics and Recreation Areas
- Street Lighting
- Sewer Systems
- Public Latrines
- Local Council Buildings and Public Libraries

B. REVENUE GENERATING PROJECTS 80% 10% 10%

- Public markets (retail and wholesale)
- Slaughterhouses
- Commercial centers and stores
- Offices
- Potable water systems
- Trade centers and workshops
- Bus and Truck parks

C. PROCUREMENT OF EQUIPMENT 100% -

- Solid waste collection equipment
- Civil works equipment

Annex -2

TYPES OF GRANT PROJECTS, PROPOSED PORPORTIONS AND CEILINGS ON FUNDS FOR HIGH, MEDIUM AND LOW INCOME MUNICIPALITIES

Project Types Maximum Grant	Maximum grant contribution in %

	Project Types Maximum Grant Maximum grant contribution in %
	in US \$ High Medium Low
A.	SANITATION/ENVIRONMENTAL IMPROVEMENT WORKS 50 70 90
	- Public Toilets 5,500
	- Integrated public Toilets 7,300
	- Private Toilets 14,500
	- Drainage Systems 45,000
	- Solid Waste Collection Equipments 7,300
	- Pavement of Public Open Spaces 18,000
	- Public Green Areas 5,500
	- Parks Construction and Improvement 9,000
	- Ponds Rehabilitation 14,500
	- River Training 27,000
	- Waste Water Treatment Plant 22,000
	- Crematorium Construction and Improvement 9,000
	7,000
B.	INCOME GENERATING PROJECTS 27,000
	- Bus Parks
	- Shop Stalls
	- Public Markets (Hat Bazaar)
	- Shopping Complexes
	- Composed Plant
C.	SCHOOL IMPROVEMENT 22,000
C.	- Construction and Improvement of School Building including Furniture Facilities
	- Construction and improvement of School Building including Furniture Facilities
D.	FEASIBILITY STUDIES AND DESIGN 9,000 70 80 90
Б. Е.	SUPERVISION OF CONSTRUCTION PROJECTS 11,000 100 100
L.	100
F.	
Г.	PROCUREMENT OF TECHNICAL IMPROVEMENT 9,000 50 70 90
G.	BASE MAP 9,000 50 70 90
Н.	MUNICIPAL BUILDING 80
11.	
	- Construction of new building 14,500
т	- Improvement of existing building 7,500
I.	MISCELLANEOUS

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